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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1964

MRS. EDNA BRITT ..... Petitioner

vs.

UNITED STATES OF AMERICA ..... Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1964

No._____

MRS. EDNA BRITT.....Petitioner

vs.

UNITED STATES OF AMERICA.....Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Mrs. Edna Britt prays that a Writ of Certiorari may issue from this Honorable Court to review the judgment and order of the United States Court of Appeals for the Fifth Circuit hereinafter set out in Section B of this petition.

A.

OPINION BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit reversing the decision of the District Court in favor of petitioner is reported in 335 F.2d 907. A copy of said opinion is appended.[1]

B.

JURISDICTIONAL GROUNDS

(i) The judgment sought to be reviewed was dated the 12th day of August, 1964, and was entered on the same date. The judgment was issued as the

1. See Appendix, Page A15.

mandate of the Court of Appeals to the District Court on the 3rd day of September, 1964. A copy of said judgment is appended.[2]

(ii) No petition for rehearing was filed nor any order relating thereto entered. No order extending the time within which this petition might be filed was sought or entered.

(iii) This court has jurisdiction to review the judgment in question by a writ of certiorari.[3]

C.

QUESTIONS PRESENTED

1. Is that portion of the brokerage fees charged borrowers by a loan broker, on the cash receipts and disbursements method of accounting, retained by the lender in a reserve fund to secure the broker's endorsement of the borrower's notes, received by and taxable to the broker in the year retained by the lender where broker has no access whatsoever to the reserve fund in question, and may never have?

2. Is a reserve fund as described above where set up as a reserve against bad debt, properly deductible as a bad debt expense, in the year set aside?

3. Is the opinion and judgment of the Court of Appeals for the Fifth Circuit in conflict with the opinion of this court in *Commissioner v. Hansen,* 360 U.S. 446, 79 S.Ct. 1270, 3 L.Ed. 2d 1360?

4. Is the opinion and judgment of the Court of Appeals in conflict with a Law of the Congress, the "Dealer

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2. See Appendix, Page A25.
3. 28 USC § 1254(1) and § 2101(c)

Reserve Adjustment Act of 1960", Pub. L. 86-459, 26 U.S.C., § 481, note?[4]

5. Is the opinion and judgment of the Court of Appeals for the Fifth Circuit in this cause in conflict with the decisions of the Courts of Appeal of other circuits, namely: *Wilkins Pontiac v. Commissioner*, 298 F.2d 893 (9th Cir., 1961), and *Foster Frosty Foods, Inc. v. Commissioner*, 332 F.2d 230, (10th Cir., 1964)?

6. Is the opinion and judgment of the Court of Appeals inconsistent with the position taken by the Commissioner of Internal Revenue in other litigation involving essentially the identical question, i.e., *Torti v. United States of America*, Civil Action No. D-C-38-62 from the docket of the United States District Court of the Northern District of Mississippi?[5]

D.

STATUTES AND REGULATIONS INVOLVED

Because of the length of the provisions involved, said provisions are only cited here, the relevant portions of each being set forth in the argument or in the appendix.[6]

United States Code:

Title 26, § 166(c)
§ 446
§ 451
§ 481, note (Pub. L. 86-459)
(§ 1 - § 3(c))

United States Treasury Regulations:

§ 1.166-1 (a)
§ 1.166-4 (a)

4. See Appendix, Page A2.
5. See Appendix, Page A27.
6. See Appendix, Page A1.

§ 1.446-1 (a), (b), and (c-1)
§ 1.451-1
§ 1.451-2

E.

STATEMENT OF THE CASE

1.

JURISDICTION

Federal jurisdiction in the first instance was vested in the United States District Court for the Southern District of Mississippi by 28 U.S.C., § 1346(a)1 and § 1402, the same being an action to collect income taxes alleged to have been erroneously assessed and collected, and the plaintiff residing in said district.

2.

PLEADINGS AND PROCEEDINGS

As all differences between the parties as to matters of fact were resolved in a Stipulation of Facts (T. 34), only that stipulation, the complainant (T. 2), the answer (T. 17), the opinion of the District Court in favor of petitioner here (T. 70), and the opinion of the Court of Appeals reversing the District Court[7] are of interest or significance here.

3.

STATEMENT OF FACTS

As no testimony was taken in this cause, the findings and opinion of both the District Court and Court of Appeals are based upon the stipulation of facts agreed to

7. See Appendix, Page A15.

by the parties (T. 34) to which the Court is respectfully referred.

Briefly, however, petitioner's deceased husband, the broker, was engaged in the small loan business and maintained his records on the cash receipts and disbursements method of accounting. He maintained a place of business to which his customers, borrowers, would come, seeking loans. The broker had a contract (T. 27) with another concern, the lender, providing that lender would make loans to such of broker's customers whose credit it approved, upon broker's endorsement and guaranty of each note. Broker would receive for his services a "service charge", or brokerage fee, which was paid to him by the borrower from the proceeds of the loan. However, said contract provided for the maintenance of a "guaranty fund" or reserve in the hands of the lender, to secure broker's endorsement of the notes of his customers, and provided that lender would retain from the proceeds of each loan, as made, a portion of broker's service charge, which was credited to and held in said reserve account. Broker had no access to or control over the reserve account until such time as it exceeded 25% of the total balance on all notes held by lender and endorsed by broker, which never occurred. Broker, being on the cash receipts and disbursement method of accounting, excluded from his income that portion of his brokerage so retained by the lender in the reserve account. The United States contends he is also liable for income taxes on that portion of his service fee retained by lender during the year in question. The District Court held that the portion of the brokerage so retained by the lender in the reserve account was not received by the broker and therefore not taxable to him. The Court of Appeals reversed and held to the contrary.

F.

ARGUMENT

PRELIMINARY STATEMENT

Petitioner sincerely feels that the question here involved is of vital interest to a broad segment of American business, and that its prompt and final disposition is of the utmost importance thereto. As such it is clearly within both the spirit expressed by this Court in Rule 19 of its Revised Rules as to when it will exercise its discretion by way of certiorari, and within the letter of some of the examples set forth therein.

The introduction of credit and consumer finance into our economy has probably been the most significant factor in the phenomenal growth of that economy in the last two decades. Practically every product and practically every service can be acquired on some sort of "pay later" basis. At the same time, practically no business has the capital to both produce and sell its product or service and to await payment of these deferred obligations.

As a result, the consumer finance industry itself has come into being and has grown to the point that it finances the credit sales of practically all other industries, either by the purchase directly therefrom of consumer instalment obligations, or by making loans directly to the customers themselves, as was done here.

In the great majority of instances, the retailer of the goods or services, or the arranger (or broker) of the direct loan, endorses and remains liable for the consumer obligation until it is paid in full. The financial institution, or lender, usually retains a portion of the proceeds of the

note in a reserve account to secure the endorsement of the retailer or loan broker.

These developments have inevitably led to complications in ascertaining just how much actual income a particular business has in any given year, because, though it has sales or brokerage fees in excess of its expenses, it nevertheless remains contingently liable on its customers' obligations, and will inevitably be called on to pay a portion thereof. In recognition thereof, some retailers or brokers have chosen to exclude from their income that portion of the proceeds of the customer notes, or brokerage fees, which are retained by the lending company or financial institution in such a reserve account. Others have chosen to set up a "reserve for bad debt" account on their own books, against this inevitable loss on the contingent obligations, charging the same as an expense item, and reducing the apparent income to a true figure.

Another factor of vital importance here is on which of the two basic accounting methods the business in question keeps its books and files its tax returns, i.e., the cash receipts and disbursements method (income being recorded when received and expenses being recorded when paid), or the accrual method (income being reported when earned and expenses being reported when incurred).

Of course, the handling of these reserves and the accounting method employed affects the ascertainment of the true income of the business in question, and therefore its income tax liability for that year. The Commissioner of Internal Revenue has, therefore, had an ever increasing interest in the handling of these various reserves.

1.

THE COURT OF APPEALS HAS ERRONEOUSLY DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE PASSED UPON BY THIS COURT.

In 1931, the Commissioner of Internal Revenue first displayed interest in retained reserve funds as to taxpayers employing either method of accounting, when he formally took the position that such funds, though subject to contingent liabilities, nevertheless met the definition of *accrued* income, and were therefore taxable to the taxpayer *on the accrual method of accounting.*[8]

The importance and significance of the question having increased, in 1958 the Commissioner restated his views on the subject as follows:

> "Amount withheld by banks or finance companies to cover possible losses on notes purchased from dealers constitute income *to dealers employing the accrual method of accounting,* to the extent of their interest therein at the time the amounts are recorded on the books of the bank or finance company as a liability to the dealer . . ."[9] (Emphasis Supplied)

As might be anticipated, the matter was contested in various forums between the Commissioner on the one hand, and various accrual basis taxpayers on the other hand, with the result that by 1959, a conflict had occurred in the decisions of six of the Courts of Appeals, four of them having held that the retained reserves did not even *accrue* to taxpayers on the accrual method of account-

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8. G.C.M. 9571, X-2 Cum Bull 153
9. Rev. Rul. 57-2, 1957-1 Cum Bull 17

ing.[10] and two of them sustaining the position of the Commissioner.[11]

This Court then granted certiorari in *Commissioner v. Hansen,* 360 U.S. 446, 79 S.Ct. 1270, 3 L. Ed. 2d 1360 (1959), and after thorough consideration, held that such reserves did *accrue* to taxpayers *on the accrual method of accounting.*

Insofar as petitioner is advised, the instant case is the first in which even the Commissioner has gone beyond his earlier contentions that such reserves accrue and are taxable to an accrual basis taxpayer, and has asserted that they are *received* by and taxable to a *cash receipts and disbursements basis taxpayer.* Therefore, the Court of Appeals for the Fifth Circuit has, in the instant case, had the opportunity to pass on the question raised by the Commissioner's new assertion. As there are tens of thousands of business firms on the cash receipts and disbursements basis of accounting, with contingent liabilities for installment obligations of their customers owing directly to financial institutions, the question of whether or not such retained reserves are received by and therefore taxable to these cash basis taxpayers, is just as important as was the determination of whether or not they accrued to accrual basis taxpayers, as was finally resolved in *Commissioner v. Hansen,* supra. The question of federal law involved here is as important as that in Hansen. Such a great number of taxpayers across such a broad segment of business being involved, it is inevitable that the question will be in time submitted to

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10. Johnson v. Commissioner, 233 F.2d 952 (4th Cir., 1956)
Texas Trailer Coach, Inc. v. Commissioner, 251 F.2d 395 (5th Cir., 1958)
Glover v. Commissioner, 253 F.2d 735 (8th Cir., 1958)
Hansen v. Commissioner, 258 F.2d 585 (9th Cir., 1958)

11. Scheaffer v. Commissioner, 258 F.2d 861 (6th Cir., 1958)
Baird v. Commissioner, 256 F.2d 918 (7th Cir., 1958)

many of the various Courts of Appeal and conflicts in their decisions are probable.

It would seem the better practice, in keeping with the function of this court, and consistent with the spirit and purpose of the exercise of its discretion as to when to grant certiorari as expressed in its Rule 19, to grant certiorari in the instant case at this time, and to promptly lay to rest, one way or the other, for all time, the vital question involved here, rather than awaiting the inevitable ground swell of litigation, and conflict in the decisions on this point.

2.

THE COURT OF APPEALS HAS DECIDED A FEDERAL QUESTION CONTRARY TO THE OPINION OF THIS COURT IN COMMISSIONER v. HANSEN, AND CONTRARY TO THE EXPRESSED WILL OF CONGRESS.

This Court should grant certiorari herein because the opinion of the Court of Appeals for the Fifth Circuit in this matter is clearly contrary to the opinion of this Court in *Commissioner v. Hansen*, supra. An understanding of the question involved in the opinion of this Court in Hansen requires a clear understanding of the difference between the accrual method of accounting, involved there, and the cash receipts and disbursements method, involved here. The Internal Revenue Code itself clearly recognizes and approves each of these two basic methods of accounting,[12] and it is amplified in the Commissioner's Income Tax regulations wherein each method is clearly defined.[13] The Commissioner's regulation explaining the proper year for including income under each of the two

12. 26 U.S.C. § 446, See Appendix, Page A1.
13. U.S. Treas. Reg. 1.446-1, See Appendix, Page A6.

methods of accounting, in amplification of the relevant section of the Internal Revenue Code[14] is in the appendix hereto,[15] but the salient portion thereof is as follows:

> "Under an accrual method of accounting, income is included in gross income when all the events have occurred which fix the right to receive such income, and the amount thereof can be determined with reasonable accuracy. . . .
>
> Under the cash receipts and disbursements method of accounting, such an amount is includable in gross income when actually or constructively received."

Constructive receipt, as used in the above quoted regulation is further defined in the Commissioner's Regulations as follows:

> "(a) General Rule. Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which *it is credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.* Thus, if a corporation credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt."[16] (Emphasis supplied)

Though in *Hansen* this Court held that the reserves in question met the above definition of accrual by holding that all events had occurred which fixed the right of the dealer to receive the income remaining in the reserve

14. 26 U.S.C. 451, See Appendix, Page A2.
15. U.S. Treas. Reg. 1.451-1, See Appendix, Page A11.
16. U.S. Treas. Reg. 1.451-2(a), See Appendix, Page A13.

fund, it clearly did not hold that the funds in the retained reserve accounts had already been *received* so as to be taxable to a cash basis taxpayer. As a matter of fact, the rationale followed by this Court in concluding that the dealer had a present fixed right to receive the income at some time in the future, clearly evidences that it was the opinion of this Court that the funds which had been placed in the reserve account had not yet been received by and would not therefore have been taxable to a cash basis taxpayer. This Court said:

> "But the question is not whether the taxpayers can presently recover their reserves, for, as stated, it is the time of acquisition of the fixed right to receive the reserves and not the time of their actual receipt that determines whether or not the reserves have accrued and are taxable." (Cf. Definition of Accrued Income, Supra) . . .
>
> "It follows that only one or the other of two things can happen to the dealers reserve account:
>
> "(1) The finance company is bound to pay the full amount to the dealer in cash, or
>
> "(2) if the dealer has incurred obligations to the finance company under his guaranty, endorsement, or contract of sale, of the installment paper, the finance company may apply so much of the reserve as is necessary to discharge those obligations, and is bound to pay the remainder to the dealer in cash.
>
> "Does the dealer 'receive' funds which are so *taken from* his reserve account and applied to the payment of his obligations to the finance company? The dealer agreed in his contract with the finance company to receive his reserve and offset payment of his obligations to the finance company and the balance in cash.

It would therefore seem that funds in the dealer's reserve which are applied to the payment of his obligations to the finance company are as much received by him as those which the finance company pays to him in cash. . . .

"It follows that the amounts (of purchase price of installment paper) that were withheld by the finance companies constituted *accrued* income to these *accrual basis* dealers at the time the withheld amounts were entered on the books of the finance company as liabilities to the dealers, for at that time the dealers acquired a fixed right to receive the amount so retained by the finance company." (Emphasis supplied)

In other words, not only did this Court clearly limit its decision of the taxability of such reserve to an accrual basis taxpayer, but expressly stated that the reserves had not yet been "*received*" by the taxpayer, but would be received by him at some time in the future in one of two ways. The position taken by the Fifth Circuit in the instant case that the funds in the reserve account have already been received by petitioner is directly contrary to the holding of this court in Hansen. It is significant that though a substantial portion of the brief and oral argument of both petitioner and respondent before the Court of Appeals dealt with this case, the opinion of the Court of Appeals failed to make any mention thereof whatsoever.

Following the decision of this Court in Hansen, it has been applied in numerous other cases by lower courts,[17]

17. Key Homes, Inc. v. Commissioner of Internal Revenue, 271 F. 2d 280 (6th Cir., 1959). Morgan v. Commissioner of Internal Revenue, 227 F.2d 152 (9th Cir., 1960). Shapiro v. Commissioner of Internal Revenue, 295 F.2d 306 (9th Cir., 1961). Wilkinson v. United States, 177 F. Supp. 101 (S. D. Ala., 1959).
Family Finance, Inc. v. Commissioner of Internal Revenue, 32 T.Ct. 1193 (1959). Also see Schulde v. Commissioner of Internal Revenue, 32 T.Ct. 1271 (1959).

but in every case it has been applied as to an accrual basis taxpayer, and expressly so. Even this Court in following Hansen so limited its application in saying:

> "This appeal from the Tax Court involves two questions. The first is whether the *accrual basis* taxpayer, a corporation, must include in its taxable income amounts held to its credit in a 'dealer's reserve account' by a finance company which had purchased its customers' notes during the year in which the finance company credits it to the dealer taxpayer."[18]

The question of law decided by this Court in Hansen was so important and its effect on the vast number of accrual basis taxpayers affected was so severe that Congress enacted the "Dealer Reserve Income Adjustment Act of 1960,"[19] which gave dealer-taxpayers who had not theretofore been including retained reserves in their income, certain options with regard to spreading the payment of the tax thereon out over a several year period. The report of the Senate Finance Committee on this bill expressly stated that its purpose was to soften the effect of *Commissioner v. Hansen*, supra, on the taxpayers affected thereby. However, the act expressly limited its application to those taxpayers who computed their taxable income under the accrual method of accounting. The Court of Appeals for the Seventh Circuit defined the taxpayers affected by Hansen as:

> "Dealers in tangible property, *who employed an accrual method of accounting*, and who, through the sale of negotiable installment paper, acquired dealer reserve accounts, . . ." (Emphasis supplied)

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18. General Gas v. Commisioner of Internal Revenue, 293 F.2d 35, (5th Cir., 1961). See also United States v. Mitchell, 283 F.2d 935 (5th Cir., 1960).

19. (P.L. 86-459, H.R. 8684) 26 U.S.C. §481, Note, See Appendix, Page A2.

and explained its purpose as:

> "To alleviate the possibility of harsh consequences upon a substantial number of dealer-taxpayers expected to arise from the involuntary change of accounting method which Hansen required, Congress, on May 13, 1960, enacted the Dealer Reserve Income Adjustment Act of 1960."[20]

Certainly Congress had no intention to provide an easing of the blow of Hansen on accrual basis taxpayers, but to deny any such relief to cash basis taxpayers. Congress was clearly of the opinion that Hansen had held that such reserves were accrued to and therefore taxable to accrual basis taxpayers, but that at the same time, it held that such reserves were not received by and therefore not taxable to cash receipts and disbursements basis taxpayers. By this legislation, Congress made the position taken by the Court of Appeals in this case unlawful.

In summary, in Hansen, this Court not only resolved the conflict theretofore existing between the various Courts of Appeal as to whether or not reserves such as that involved here even accrued to an accrual basis taxpayer, but clearly announced that the same would not be received by a cash basis taxpayer until paid to him or credited against his contingent liability, and were therefore not received by or taxable to him in the year in which retained in the reserve fund.

3.

THE COURT OF APPEALS HAS RENDERED A DECISION IN CONFLICT WITH THE DECISIONS OF OTHER COURTS OF APPEAL.

In its opinion in this cause, the Court of Appeals for the Fifth Circuit has taken the position that the taxpayer

20. American Community Builders, Inc. v. Commissioner of Internal Revenue, 301 F.2d 7 (7th Cir., 1962).

received the full economic benefit of that portion of his brokerage retained by the lender in the reserve account. It should be noted that the Court of Appeals has disallowed the deduction of this entire reserve as an expense item. In his original tax return for the year in question, the taxpayer deducted the reserve in question as an expense item captioned: "Lender's reserve—$4,608.58" (T 43). In order to fully earn his brokerage fees, the taxpayer had to bring the borrower and the lender together, do all the clerical work relating to the loan, and to endorse and guarantee payment of the customer's note to the lender. That endorsement and guaranty would not be fulfilled in full until the note was paid in full. The broker had not earned his brokerage fee in full as to any one particular note, until that note was paid in full. Accordingly, he was clearly entitled to establish a reserve against bad debt to offset this continuing contingent liability he had.[21]

Though the Commissioner of Internal Revenue has long contended that no reserve for bad debt could be established against a contingent liability, and though the Tax Court has supported the Commissioner in at least two instances,[22] it has been reversed by the Courts of Appeal of both the Ninth and Tenth Circuits.

In *Wilkins Pontiac v. Commissioner,* 298 F.2d 893 (9th Cir., 1961) the question was whether or not a retail automobile dealer's additions to a bad debt reserve would constitute an expense to him for the year in question, where the reserve offset his contingent liability on conditional sales contracts and notes which had been assigned to G.M.A.C. In reversing the Tax Court and rejecting the argument of the Commissioner, the Court stated:

21. 26 U.S.C. 166(c), Reg. 1.166-1(a), and 1.166-4(a), See Appendix, Pages A1 and A6.
22. Wilkins Pontiac v. Commissioner, 34 T.C. 1065
Foster Frosty Foods, Inc. v. Commissioner, 39 T.C. 772

"From this the Commissioner reasons that a bona fide debt and a debtor-creditor relationship are required to exist before additions to the reserves are deductible. We do not so read the regulations. They are here defining 'bad debts' and thus would seem to have reference to § 166(a). § 166(c) deals with a situation where a bona fide debt has not yet become worthless, but where there is an existing risk of such a loss. The risk is every bit as real to this taxpayer under its contract of guaranty as it would be where the debt is now owed directly to it. Its obligations presently expose it to risk of loss and that risk under *Putnam*[23] is a § 166(a) risk."

Foster Frosty Foods, Inc. v. Commissioner, 332 F.2d 230 (10th Cir., 1964), again reversed the Tax Court and held contrary to the contentions of the Commissioner on the identical question involved in *Wilkins Pontiac v. Commissioner,* supra, the Court saying:

"In rejecting any consideration of the existence of discounted notes and contracts assigned to banks with recourse in determining allowable reserves for bad debts, the reasoning of the Commissioner and the decision of the Tax Court get no further than the flat statement that no debt exists between petitioner and its customer after assignment. The premise is faulty in application and has been rejected by the Ninth Circuit in Wilkins Pontiac v. Commissioner, 298 F.2d 893. The assignment and discounting of commercial paper with recourse is but a method of obtaining working capital and the tax concept of debt remains existent because of the continuing liability of guaranty. Putnam v. Commissioner, 352 U.S. 82. The purpose of a reserve

23. Putnam v. Commissioner, 352 U.S. 82, 77 S.Ct. 175, 1 L.Ed.2d 144 (1956).

for bad debts, intended as it is to allow a deduction against current income for bad debts attributable to such income but arising later, would be defeated if its concept is limited to direct debt. . . ."

These decisions of the 9th and 10th Circuits were followed and applied in one case involving the reserve against bad debts set up by a loan broker operating under the same procedure and the same regulatory statutes of the State of Mississippi in *Family Budget Service, Inc. v. United States,* 64-1 U.S.T.C. 9151. The United States acquiesced in the decision of the trial court and dismissed its appeal.

There is no question but that the Courts of Appeal for the 9th and 10th Circuits in the above cited cases have clearly rejected the contention of the Commissioner of Internal Revenue and have held that a bad debt reserve may be established against contingent liabilities and deducted in the current year. The Court of Appeals for the Fifth Circuit, in the instant case, in disallowing the taxpayer's attempted deduction of the reserve in question as an expense item, has sustained the position of the Commissioner and its holding is therefore directly contrary to that of the Ninth and Tenth Circuits. Accordingly, this Court should grant certiorari herein to resolve this conflict.

4.

THE COURT OF APPEALS HAS, AT THE INSTANCE OF THE COMMISSIONER OF INTERNAL REVENUE, RENDERED AN OPINION DIRECTLY CONTRARY TO THE POSITION TAKEN BY THE COMMISSIONER ON THE SAME QUESTION IN OTHER LITIGATION.

It would be unconscionable for the Commissioner of Internal Revenue to be allowed to take one position with

regard to one taxpayer, and turn around and take the opposite position with regard to another taxpayer on the identical question in other litigation. Such a situation certainly should call for the exercise by this Court of its discretion and the issuance of a Writ of Ceriorari to review the action of the Court of Appeals.

In the instant case, the Commissioner of Internal Revenue took the position that the reserve in question had been received by and was taxable to the taxpayer, even though he was on the cash receipts basis of accounting. Though the District Court found to the contrary, the Court of Appeals sustained that position of the Commissioner. At substantially the same time, there was filed in the United States District Court for the Northern District of Mississippi, in the Delta Division, a case styled *Joseph W. Torti and Katherine A. Torti v. United States of America*, being Civil Action No. D-C-38-62. A certified copy of the complete record in this cause has been obtained by petitioner, and the same is reproduced in the appendix hereto,[24] together with an affidavit stating that the Commissioner paid the plaintiff's claim for refund in full.[25]

An examination of this related case reveals that the taxpayer involved there was likewise a small loan broker operating in compliance with the same statutes under which petitioner here operates. The pleadings further reveal that the sole question with which the court was confronted there was whether or not the brokerage of the loan broker held by the lender in a reserve account to secure broker's endorsement, was taxable to the broker when retained. This is the identical question involved in the instant case.

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24. See Appendix, Page A27.
25. See Appendix, Page A53.

The only possible distinction between the cases is that in the Torti case the lender retained the broker's entire brokerage in the reserve account at the time the loan was made, and remitted only that portion of the loan which was to be received by the customer himself. The broker would then, as each payment was made on the loan, retain that portion of the payment applicable to his brokerage fee, and would remit the balance to the lender, who credited it against the note. In the instant case, the lender retained only a portion of the broker's brokerage in the reserve account, and remitted the balance to the broker along with the customer's proceeds of the loan. The distinction is immaterial and results purely from the taxpayer involved having chosen to follow that particular procedure. Surely this Court will not permit the Commissioner of Internal Revenue to concede the nontaxability of the reserve in Torti, where the entire brokerage was retained, and at the same time to assert that the reserve in the instant case is taxable. A Writ of Certiorari should be granted by this Court, as prayed for, to review the opinion of the Court of Appeals and resolve this inconsistency.

CONCLUSION

Counsel is not unmindful that the function of this petition is to persuade this Court that the action of the Court of Appeals should be reviewed, and not merely to persuade this Court that the Court of Appeals has erred. However, counsel does feel that the Court of Appeals has erred, and grievously so. At the same time, however, counsel sincerely feels that this cause is an appropriate one for the issuance of a Writ of Certiorari, not merely to correct error, or to set right a wrong, but because the question involved and presented in this cause is significant, because it applies to a vast number of taxpaying

businesses of the United States, because conflicts are developing and will continue to develop within our courts hereon, and because conflicts and indecision are apparently developing in the office of the Commissioner of Internal Revenue thereon itself. Accordingly, petitioner respectfully prays for the issuance of the Writ of Certiorari hereinabove applied for.

CERTIFICATE OF SERVICE

I, James Leon Young, one of the attorneys for petitioner herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that I have this date served the foregoing Petition for Certiorari to the United States Court of Appeals for the Fifth Circuit, on the United States, respondent, by mailing true and correct copies thereof air mail, postage prepaid, to:

The Solicitor General
Department of Justice
Washington 25, D.C.

Louis F. Oberdorfer
Assistant Attorney General
Tax Division
Department of Justice
Washington 25, D.C.

Lee A. Jackson, Chief
Appellate Section
Department of Justice
Washington 25, D.C.

This the.....day of November, 1964.

James Leon Young
1540 Deposit Guaranty Bank Building
Jackson, Mississippi

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UNITED STATES CODE

Title 26, Section 166 (c) A1

Section 446 (a), (b), (c), (d) A1

Section 446 (e) A2

Section 451 (a), (b) A2

Section 481, Note (P.L. 86-459, H. R. 8684) A2

UNITED STATES TREASURY REGULATIONS

Section 1.166-1 (a) A6

Section 1.166-4 (a) A6

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APPENDIX

UNITED STATES CODE

Title 26.

§ 166(c). Reserve for bad debts.—In lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary or his delegate) a deduction for a reasonable addition to a reserve for bad debts.

§ 446. General rule for methods of accounting

(a) General rule.—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) Exceptions.—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

(c) Permissible methods.—Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary or his delegate.

(d) Taxpayer engaged in more than one business.—A taxpayer engaged in more than on trade or business

may, in computing taxable income, use a different method of accounting for each trade or business.

(e) Requirement respecting change of accounting method.—Except as otherwise expressly provided in this chapter, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary or his delegate.

§ 451. General rule for taxable year of inclusion

(a) General rule.—The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

(b) Special rule in case of death.—In the case of the death of a taxpayer whose taxable income is computed under an accrual method of accounting, any amount accrued only by reason of the death of the taxpayer shall not be included in computing taxable income for the period in which falls the date of the taxpayer's death.

§ 481, note, DEALER RESERVE INCOME ADJUSTMENT ACT OF 1960
(P. L. 86-459, H. R. 8684)

SECTION 1. SHORT TITLE.

This Act may be cited as the "Dealer Reserve Income Adjustment Act of 1960."

SECTION 2. PERSONS TO WHOM THIS ACT APPLIES.

This Act shall apply to any person who, for his most recent taxable year ending on or before June 22, 1959—

(1) computed, or was required to compute, taxable income under an accrual method of accounting,

(2) treated any dealer reserve income, which should have been taken into account (under the accrual method of accounting) for such taxable year, as accruable for a subsequent taxable year, and

(3) before September 1, 1960, makes an election under section 3(a) or 4(a) of this Act.

SECTION 3. ELECTION TO HAVE SECTION 481 APPLY.

(a) GENERAL RULE—If—

(1) for the year of the change (determined under subsection (b)), the treatment of dealer reserve income by any person to whom this Act applies is changed to a method proper under the accrual method of accounting (whether or not such person initiated the change),

(2) such person makes an election under this subsection, and

(3) such person does not make the election provided by section 4(a), then, for purposes of section 481 of the Internal Revenue Code of 1954, the change described in paragraph (1) shall be treated as a change in method of accounting not initiated by the taxpayer.

(b) YEAR OF CHANGE, ETC.—In applying section 481 of the Internal Revenue Code of 1954 for purposes of this section, the "year of the change" in the case of any person is—

(1) except as provided in paragraph (2), the first taxable year ending after June 22, 1959, or

(2) the earliest taxable year (whether the Internal Revenue Code of 1954 or the Internal Revenue Code of 1939 applies to such year) for which—

(A) on or before June 22, 1959—

(i) the Secretary of the Treasury or his delegate issued a notice of deficiency, or a written notice of a proposed deficiency, with respect to dealer reserve income, or

(ii) such person filed with the Secretary or his delegate a claim for refund or credit with respect to dealer reserve income, and

(B) the assessment of any deficiency, or the refund or credit of any overpayment, whichever is applicable, was not, on June 21, 1959, prevented by the operation of any law or rule of law.

For purposes of this section, section 481 of such Code shall be treated as applying to any year of the change to which the Internal Revenue Code of 1939 applies.

SECTION 4. ELECTION TO HAVE SECTION 481 NOT APPLY; PAYMENT IN INSTALLMENTS.

(a) GENERAL RULE.—If a person to whom this Act applies makes an election under this subsection, then for purposes of chapter 1 of the Internal Revenue Code of 1954 (and the corresponding provisions of prior law) a change in the treatment of dealer reserve income to a method proper under the accrual method of accounting shall be treated as not a change in method of accounting in respect of which section 481 of the Internal Revenue Code of 1954 applies. Any election under this subsection shall apply to all taxable years ending on or before June 22, 1959 (whether the provisions of the Internal Revenue Code of 1954 or the corresponding provisions of prior law apply), for which the assessment of any deficiency, or for which refund or credit of any overpayment, which-

ever is applicable, was not, on June 21, 1959, prevented by the operation of any law or rule of law.

(b) ELECTION TO PAY TAX IN INSTALLMENTS.—

(1) Eligibility.—If the net increase in tax (as defined in paragraph (2)) which results solely from the effect of the election provided by subsection (a) exceeds $2,500, then the taxpayer may elect (at the time the election is made under subsection (a)) to pay in two or more (but not to exceed 10) equal annual installments any portion of such net increase which (on the date of such election) is unpaid.

(2) Net Increase in Tax Defined.—For purposes of this section, the term "net increase in tax" means the amount (if any) by which—

(A) the sum of the increases in tax (including interest) for all taxable years to which the election applies and which is attributable to the election, exceeds

(B) the sum of the decreases in tax (including interest) for all taxable years to which the election applies and which is attributable to the election.

For purposes of this paragraph, interest for the period before the date of the election shall be computed as provided in chapter 67 of the Internal Revenue Code of 1954 (or the corresponding provisions of prior revenue laws).

(c) Due Date for Installments.—If an election is made under subsection (b), the first installment shall be paid on or before the date prescribed by section 6151(a) of the Internal Revenue Code of 1954 for payment of the tax for the taxable year in which the election was made,

and each succeeding installment shall be paid on or before the date which is one year after the date prescribed by this subsection for payment of the preceding installment.

UNITED STATES TREASURY REGULATIONS

§ 1.166-1 Bad debts

(a) Allowance of deduction. Section 166 provides that, in computing taxable income under section 63, a deduction shall be allowed in respect of bad debts owed to the taxpayer. For this purpose, bad debts shall, subject to the provisions of section 166 and the regulations thereunder, be taken into account either as—

(1) A deduction in respect of debts which become worthless in whole or in part; or as

(2) A deduction for a reasonable addition to a reserve for bad debts.

§ 1.166-4 Reserve for bad debts

(a) Allowance of deduction. A taxpayer who has established the reserve method of treating bad debts and has maintained proper reserve accounts for bad debts or who, in accordance with paragraph (b) of § 1.166-1, adopts the reserve method of treating bad debts may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of deducting specific bad debt items.

§ 1.446-1 General rule for methods of accounting

(a) General rule. (1) Section 446 (a) provides that taxable income shall be computed under the method of accounting on the basis of which a taxpayer regularly computes his income in keeping his books. The term "method of accounting" includes not only the over-all method of accounting of the taxpayer but also the ac-

counting treatment of any item. Examples of such overall methods are the cash receipts and disbursements method, an accrual method, combinations of such methods, and combinations of the foregoing with various methods provided for the accounting treatment of special items. These methods of accounting for special items include the accounting treatment prescribed for research and experimental expenditures, soil and water conservation expenditures, depreciation, net operating losses, etc. Except for deviations permitted or required by such special accounting treatment, taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. For requirement respecting the adoption or change of accounting method, see section 446(e) and paragraph (e) of this section.

(2) It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are, in his judgment, best suited to his needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. A method of accounting which reflects the consistent application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income, provided all items of gross income and expense are treated consistently from year to year.

(3) Items of gross income and expenditures which are elements in the computation of taxable income need not be in the form of cash. It is sufficient that such items can be valued in terms of money. For general rules relating to the taxable year for inclusion of income and for

taking deductions, see sections 451 and 461, and the regulations thereunder.

(4) Each taxpayer is required to make a return of his taxable income for each taxable year and must maintain such accounting records as will enable him to file a correct return. See section 6001 and the regulations thereunder. Accounting records include the taxpayer's regular books of account and such other records and data as may be necessary to support the entries on his books of account and on his return, as for example, a reconciliation of any differences between such books and his return. The following are among the essential features that must be considered in maintaining such records:

(i) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, merchandise on hand (including finished goods, work in process, raw materials, and supplies) at the beginning and end of the year shall be taken into account in computing the taxable income of the year. (For rules relating to computation of inventories, see sections 471 and 472, and the regulations thereunder.)

(ii) Expenditures made during the year shall be properly classified as between capital and expense. For example, expenditures for such items as plant and equipment, which have a useful life extending substantially beyond the taxable year, shall be charged to a capital account and not to an expense account.

(iii) In any case in which there is allowable with respect to an asset a deduction for depreciation, amortization, or depletion, any expenditures (other than ordinary repairs) made to restore the asset or prolong its useful life shall be added to the asset account or charged against the appropriate reserve.

(b) Exceptions. (1) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation of taxable income shall be made in a manner which, in the opinion of the Commissioner, does clearly reflect income.

(2) A taxpayer whose sole source of income is wages need not keep formal books in order to have an accounting method. Tax returns, copies thereof, or other records may be sufficient to establish the use of the method of accounting used in the preparation of the taxpayer's income tax returns.

(c) Permissible methods—(1) In general. Subject to the provisions of paragraphs (a) and (b) of this section, a taxpayer may compute his taxable income under any of the following methods of accounting:

(i) Cash receipts and disbursements method. Generally, under the cash receipts and disbursements method in the computation of taxable income, all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received. Expenditures are to be deducted for the taxable year in which actually made. For rules relating to constructive receipt, see § 1.451-2. For treatment of an expenditure attributable to more than one taxable year, see section 461(a) and paragraph (a) (1) of § 1.461-1.

(ii) Accrual method. Generally, under an accrual method, income is to be included for the taxable year when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Under such a method, deductions are allowable for the taxable year in which all the events have occurred which establish the fact of

the liability giving rise to such deduction and the amount thereof can be determined with reasonable accuracy. The method used by the taxpayer in determining when income is to be accounted for will be acceptable if it accords with generally recognized and accepted income tax accounting principles and is consistently used by the taxpayer from year to year. For example, a taxpayer engaged in a manufacturing business may account for sales of his product when the goods are shipped, when the product is delivered or accepted, or when title to the goods passes to the customer, whether or not billed, depending upon the method regularly employed in keeping his books. Likewise, the extent to which indirect costs shall be included in computing cost of goods sold depends upon the method used by the taxpayer in treating such items in keeping his books.

(iii) Other permissible methods. Special methods of accounting are described elsewhere in chapter 1 of the Code and the regulations thereunder. For example, see the following sections and the regulations thereunder: Sections 61 and 162, relating to the crop method of accounting; section 453, relating to the installment method; section 451, relating to the long-term contract methods. In addition, special methods of accounting for particular items of income and expense are provided under other sections of chapter 1. For example, see section 174, relating to research and experimental expenditures, and section 175, relating to soil and water conservation expenditures.

(iv) Combinations of the foregoing methods. (a) In accordance with the following rules, any combination of the foregoing methods of accounting will be permitted in connection with a trade or business if such combination clearly reflects income and is consistently used. Where

a combination of methods of accounting includes any special methods, such as those referred to in subdivision (iii) of this subparagraph, the taxpayer must comply with the requirements relating to such special methods. A taxpayer using an accrual method of accounting with respect to purchases and sales may use the cash method in computing all other items of income and expense. However, a taxpayer who uses the cash method of accounting in computing gross income from his trade or business shall use the cash method in computing expenses of such trade or business. Similarly, a taxpayer who uses an accrual method of accounting in computing business expenses shall use an accrual method in computing items affecting gross income from his trade or business.

(b) A taxpayer using one method of accounting in computing items of income and deductions of his trade or business may compute other items of income and deductions not connected with his trade or business under a different method of accounting.

§ 1.451-1 General rule for taxable year of inclusion

(a) General rule. Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the

taxable year in which the determination can be made. Under the cash receipts and disbursements method of accounting, such an amount is includible in gross income when actually or constructively received. Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. To the extent that income is attributable to the recovery of bad debts for accounts charged off in prior years, it is includible in the year of recovery in accordance with the taxpayer's method of accounting, regardless of the date when the amounts were charged off. For treatment of bad debts and bad debt recoveries, see sections 166 and 111 and the regulations thereunder. For rules relating to the treatment of amounts received in crop shares, see section 61 and the regulations thereunder. For the year in which a partner must include his distributive share of partnership income, see section 706(a) and paragraph (a) of § 1.706-1. If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom.

(b) Special rule in case of death. (1) A taxpayer's taxable year ends on the date of his death. See section 443 (a) (2) and paragraph (a) (2) of § 1.443-1. In computing taxable income for such year, there shall be included only amounts properly includible under the method of accounting used by the taxpayer. However, if the

taxpayer used an accrual method of accounting, amounts accrued only by reason of his death shall not be included in computing taxable income for such year. If the taxpayer uses no regular accounting method, only amounts actually or constructively received during such year shall be included. (For rules relating to the inclusion of partnership income in the return of a decedent partner, see subchapter K, chapter 1 of the Code, and the regulations thereunder.)

(2) If the decedent owned an installment obligation the income from which was taxable to him under section 453, no income is required to be reported in the return of the decedent by reason of the transmission at death of such obligation. See section 453(d) (3). For the treatment of installment obligations acquired by the decedent's estate or by any person by bequest, devise, or inheritance from the decedent, see section 691(a) (4) and the regulations thereunder.

§ 1.451-2 Constructive receipt of income

(a) General rule. Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Thus, if a corporation credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

(b) Examples of constructive receipt. Interest coupons which have matured and are payable but which have not been cashed are constructively received in the tax-

able year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. Dividends on corporate stock are constructively received when unqualifiedly made subject to the demand of the shareholder. However, if a dividend is declared payable on December 31 and the corporation followed its usual practice of paying the dividends by checks mailed so that the shareholders would not receive them until January of the following year, such dividends are not considered to have been constructively received until January. Interest on savings bank deposits is income to the depositor when credited on the books of the bank, even though the bank has a rule, seldom or never enforced, that it may require a certain number of days' notice before withdrawals are permitted. Generally, the amount of dividends or interest credited to shareholders of organizations such as building and loan associations or cooperative banks, is income to the shareholders for the taxable year when credited. However, if the amount of such dividends or interest is not available for the shareholders' free and unrestricted use at the time credited, such amount is not constructively received and does not constitute income to the shareholder until the taxable year in which the amount is available. Accordingly, if the amount of dividends or interest is accumulated and is not available to the shareholder until the maturity of a share, the crediting thereof to the shareholder's account does not constitute constructive receipt. However, in such a case the total amount credited is income to the shareholder in the year of maturity.

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 20968

UNITED STATES OF AMERICA ..... Appellant

versus

MRS. EDNA BRITT ..... Appellee

Appeal from the United States District Court for the Southern District of Mississippi.

(August 12, 1964.)

Before TUTTLE, Chief Judge, and POPE* and BROWN, Circuit Judges.

POPE, Circuit Judge: This case involves a dispute over the taxability as income of certain funds involved in small loan transactions in Mississippi. A deficiency letter had been issued to taxpayer, the deceased husband of plaintiff Edna Britt, and he had paid the deficiency. His widow sues to recover that amount.

The small loan business in Mississippi is regulated by the Small Loan Regulatory Act, Miss. Laws (1958), c. 170; 4A Miss. Laws Anno. Sec. 5591 (1962 Supp.). Three parties are involved in small loan transactions: the borrower; the broker, who arranged and guaran-

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* Of the Ninth Circuit, sitting by designation.

tees the loan; and the lender, who puts up the money. Taxpayer was a broker.

To understand clearly the dispute in this case the facts of the transactions in which the broker taxpayer was engaged must be set forth in some detail. A prospective borrower would go to the broker's office; the borrower would fill out a loan application and at the same time he would sign a note agreeing to pay back the loan plus interest and plus the broker's fee if the loan is approved; the broker would then forward the application to the lender together with a statement of the amount of the loan applied for. Under his contract with the lender, the broker agreed to guarantee all loans made by the lender to the broker's clients, and to ensure that he could fulfill this guaranty, the broker was required to keep on deposit with the lender an amount equal to 25 per cent of the loans outstanding to the broker's clients. The broker could amass this fund in two ways: he could deposit the amount with the lender, or he could "deposit with the lender three per cent (3%) of the amount of each draft drawn by the Broker on the Lender on behalf of the Broker's customers, which said three per cent (3%) shall be deposited in the guaranty fund . . ., and shall be so paid by the Broker as each draft is drawn on the Lender." If the lender approved the loan, the broker was authorized to draw a draft on the lender for the amount of the loan less discount for interest and the three percent for reserve, mentioned above. The broker then gave the borrower the amount of the draft less his service fees.[1]

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[1] To illustrate: Assume the borrower wishes to secure through such procedures $300 to be repaid in one year. The applicable law permits the lender to charge six per cent per annum; service charges and interest combined cannot exceed "two per cent of the amount of cash received by the borrower multiplied by the

The income claimed taxable here is made up of the aggregate of such reserve funds in the hands of the lender, (such as the $10.49 mentioned in the last footnote). Whether these sums were taxable to the broker in the year in which they were thus deposited with the lender depends upon a determination as to the source of such funds — who paid them, and to whom or for whom they were paid.

The Government asserts that the real transaction here was one whereby the borrower, the broker's customer, paid the broker a service fee, authorizing such fee to be withheld from the proceeds of the borrower's note. Then, said the Government, a portion of that fee was deposited with the lender as a guaranty reserve, it being arranged by broker and lender, for their convenience, that this reserve reach the lender by permitting him to withhold it from the proceeds of the note, and hence it was deducted from the amount of the draft. Thus it is contended that the broker has assigned this portion of his fee from the borrower to the lender, to meet his obligation to keep up the guarantee fund. In substance it is said the borrower has paid this fee to the broker, who has simultaneously deposited it with the lender to meet his obligation respecting guarantee deposits.

Appellee Britt's answer to this is a simple one. She says: "The reserve retained by the lender herein

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number of months for which the loan is extended". The interest and the broker's service charge combined in this case may equal $72, 2% of $300 times 12. This would make a total of $372. Interest on this sum at six percent would be $22.32. Deducting this from $72 (the total allowable interest and service charge) would leave the allowable charge $49.68. The three per cent reserve would be $10.49. The amount of the loan would include both interest and service fee $72. Lender would retain his interest ($22.32) and the reserve ($10.49) and the broker would thus draw a draft for the $300 for his customer plus the balance of his service fee ($49.68 less $10.49) or $339.19, handing $300 of this to the borrower.

in 1958 was not taxable to the taxpayer-broker in 1958, as it was not received actually or constructively in that year." This would have much force if the broker were employed or was to be paid by the lender.[2]

The trial judge's opinion accepted taxpayer's version of the transactions here involved. He inferred from the facts, all of which were stipulated, that "the fund in question never was actually or constructively received by the taxpayer during the taxable year in suit, and that the taxpayer being on a cash basis never became liable to the United States for any taxes there on."[3]

We conclude, on the basis of the contract between the parties here, and in the light of the Mississippi small loans statute which governed these transactions, that this trial court's finding is both clearly erroneous and in conflict with the controlling state statute.

The contract between the lender and the broker discloses that the fund in the reserve held by the lender was neither compensation payable by lender to broker nor a sum payable from lender for notes purchased or otherwise. The whole of the service fee (the $49.68 mentioned in footnote 1, *supra*) was payable by the borrower to the broker for services rendered borrower by

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[2] An illustration of such a situation may be found in Commissioner v. Hansen, 360 U.S. 446, where the automobile dealer, who had taken contracts from purchasers of automobiles, made a deal with the finance company in which it was recited that the dealer "does hereby sell, assign and transfer to [finance company] his . . . right, title and interest in and to the within contract." The finance company then remitted to the dealer taxpayer the major percentage of the price for this sale of the contract, retaining the remaining percentage as a "Dealers Reserve Account". There the purchase price of the paper was owed by the finance company to the taxpayer and the sum withheld was taxable to him only because he was on the accrual basis.

[3] The formal finding was: "The taxpayer did not receive, either actually or constructively, any part of the reserve fund in question during the taxable year in question."

the broker. This is in no respect altered by the fact that this sum came from the proceeds of the loan note. The contract expressly recites that the broker is engaged "in the business of soliciting loans of money for its clients of [sic] customers," that a transaction such as here involved would be initiated "when the Broker has a customer desiring a loan," and there follows "an application form filed by the customer or client of the Broker." It recites that in collection of payments on the loan the broker "should be acting solely and only as the agent of the borrowers." The borrowers are repeatedly referred to as "the Broker's customers." The contract expfessly refers to two charges: "The Lender shall charge interest on such loans made to the customers of the Broker at the maximum rate permitted by Section 9 of [the Mississippi statute]", and it was agreed that "the combined interest charged by Lender and brokerage fee charged by Broker shall not exceed the maximum under said Section 9." Thus unquestionably the broker was acting solely on behalf of his customer or client, and as his agent, and the broker's service fee was owed and payable to him by the borrower. In no sense was this service fee, or any of it, money payable by the lender.[4]

That this contract followed and conformed precisely to the requirements of the Mississippi statutes is plain from an examination of its provisions and of the Mississippi decisions. The statutes here referred to, the Small Loan Regulatory Act, and the Small Loan Privilege Act, were adopted in 1958. They appear as 4A

[4] The exhibit H made part of the stipulated record shows how the parties computed the three per cent reserve. This was calculated on what they called the "Net Amount", which included the amount of the loan advanced to the borrower, plus the full amount of the broker's commission. Thus the parties disclosed their view that the entire commission first passed to the broker who then returned the three per cent mentioned to the lender.

Miss. Stats. Anno. (1962 Supp.) Secs. 5591-01 to 5591-44, Title 21, Chap. 8. (These sections are commonly referred to as Sections 1 to 44 inclusive.) The contract, previously mentioned, expressly recites that the parties contemplate doing business pursuant to these statutes. Under them a lender and a broker must each procure licenses, and furnish bonds. "No licensee shall do a business of both handling loans and lending money." (Sec. 13.) The licensee for "handling loans" is one who does so "for a borrower for a fee, commission or charge *paid by the borrower*, and who arranges, negotiates, obtains or procures a loan of money for the borrower." (Sec. 2) (Emphasis added.) This amount charged the borrower, exclusive of interest, is called a "service charge" for services "rendered or to be rendered the borrower . . . in arranging or negotiating a loan, and for . . . guaranteeing, endorsing . . . and other actual services rendered the borrower by the licensee." (Sec. 2 (3)) "A different type license shall be issued for persons engaged in the business of lending money, either directly or indirectly, from licenses issued to persons handling loans for a fee, commission or service charge *to be paid by the borrower*" (Sec. 44.) (Emphasis added.)

We note that these Sections 2 and 44 particularly recite that under the system of small loans here employed and authorized by the statute, the broker's fee, commission or service charge is to be "paid by the borrower". This is consistent with the fact that the borrower is the customer of the broker and the broker is the borrower's agent.

That it is the borrower who agrees to pay such a fee to the broker was noted in *Early v. Williams*, 239 Miss. 320, 123 So. 2d 446 (1960) where a borrower had

defaulted on his loan and was sued. Defendant asserted the note was unenforcible because it included an amount representing the brokerage fee, which was claimed to be excessive. Said the court (pp. 328-29): "It seems incredible that any borrower, to get the sum of money which appellants received, would be willing to incur the stated expenses incident thereto. This is especially true as to the enormous brokerage fee. The right of a broker to charge a fee for his services in procuring a loan has long been recognized in the jurisprudence of this state. See Tower Underwriters Inc. v. Lott, 210 Miss. 389 . . . . Chapter 170, Laws of 1958, supra, expressly authorizes contracts such as are found in this case; and a party cannot be penalized as long as he complies with the law." In accord is *Powell v. Sowell,* 245 Miss. 53, 145 So. 2d 168 (1962).

Again, in *Hooper v. Aetna Finance Co.,* 244 Miss. 799, 145 So. 2d 907 (1962) the borrower claimed the money paid to Aetna, the broker, was interest and hence the loan contract was void because of usurious interest. This claim was rejected on the ground that the payments, aside from the principal sum and six per cent interest thereon, were service fees owed to the broker.

What all this amounts to is that these borrowers paid from the proceeds of the loan notes not only interest to the lender but also brokerage fees or service charges to the broker, Britt. That a portion of the service charge or fee was placed in the hands of the lender as security for the broker's guarantees in no manner altered the essential nature of what went on. And no material significance can turn upon the fact that Britt, instead of putting up the guaranty fund by exercising his option, stated in the contract, to deposit the same "in cash", chose to provide the deposit by deposit-

ing with the lender three per cent of the amount of each draft.

In substance then, the portion of broker's fees represented by the three per cent was paid by the borrower, and it went into the hands of the lender pursuant to the broker's agreement that it be received and held by the lender as a guaranty fund "as a means of assuring the Lender" of broker's ability to perform his guaranty of the notes. More simply stated, borrower, owing this money to broker, at the latter's direction passed the money to the lender.

In *Blalock v. Georgia Ry. & Electric Co.*, 5 Cir., 246 Fed. 387, 390, this court said: "A creditor as truly receives payment of what is due him when, pursuant to his direction, the debtor makes payment to another, as he does when payment is made directly to himself." This case was cited with approval in *Old Colony Tr. Co. v. Commissioner*, 279 U.S. 716, 730. In *Raybestos Manhattan Co. v. United States*, 296 U.S. 60, 64, the Supreme Court pointed out "Income is not any the less taxable income of the taxpayer because by his command it is paid directly to another in performance of the taxpayer's obligation to that other." In *Helvering v. Horst*, 311 U.S. 112, 116, the Supreme Court also observed: "But the rule that income is not taxable until realized has never been taken to mean that the taxpayer, even on the cash receipts basis, who has fully enjoyed the benefit of the economic gain represented by his right to receive income, can escape taxation because he has not himself received payment of it from his obligor. The rule, founded on administrative convenience, is only one of postponement of the tax to the final event of enjoyment of the income, usually the receipt of it by the taxpayer, and not one of ex-

emption from taxation where the enjoyment is consummated by some event other than the taxpayer's personal receipt of money or property. . . . If the taxpayer procures payment directly to his creditors of the items of interest or earnings due him, . . . he does not escape taxation because he did not actually receive the money."

This rule, applied to the facts in this case, compels a holding that the portions of the brokerage fees here in question which were posted with the lender were income actually received by the taxpayer, and hence taxable to him in the year here in question.

The judgment is reversed and the cause remanded with directions to enter judgment for the appellant.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT
October Term, 1963

No. 20968

D. C. Docket No. 3326 - Civil

UNITED STATES OF AMERICA ..... Appellant

versus

MRS. EDNA BRITT ..... Appellee

Appeal from the United States District Court for the Southern District of Mississippi.

Before TUTTLE, Chief Judge, and POPE* and BROWN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Mississippi, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby remanded to the said District Court with directions to enter judgment for the appellant in accordance with the opinion of this Court.

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*Of the Ninth Circuit, sitting by designation.

August 12, 1964

Issued as Mandate: Sept. 3, 1964

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF MISSISSIPPI

DELTA DIVISION

CIVIL ACTION NO. D-C-38-62

JOSEPH W. TORTI AND
KATHERINE A. TORTI ..... Plaintiffs

vs.

UNITED STATES OF AMERICA ..... Defendant

Northern District of Mississippi
FILED
SEP 10 1962

BILL OF COMPLAINT

Now come Joseph W. Torti and Katherine A. Torti, the plaintiffs in this cause, and complain of the defendant, the United States of America, and as grounds for their complaint and cause of action, allege the following:

(1)

This action is brought against the United States of America under the authority of Section 1346, Title 28 U.S.C. as amended, for the recovery of income taxes assessed and collected under the provisions of Section 1, Title 26, U.S.C.A., being the section of the Internal Revenue Code of 1954 imposing and providing for the collection of such a tax, and under all other laws or parts of laws applicable thereto, for the sum of $2,334.80, together with interest thereon, as hereinafter set forth.

(2)

Plaintiffs are, and were in the years in question, adult resident citizens of the City of Clarksdale, in Coahoma County, Mississippi, and Joseph W. Torti was a member of and a partner in a partnership firm composed of Joseph W. Torti and Rodney E. Defenbaugh, doing business in the City of Clarksdale, Mississippi, under the firm and partnership name of Defenbaugh Finance Company; the plaintiff, Joseph W. Torti, under an agreement to that effect, has a working interest in the profits of said Company, he manages the operation of the Company and receives one-third of the net profits therefrom, this partnership arrangement having been consummated on September 1, 1958, and remaining in force throughout the remainder of the term involved in this action.

(3)

The partnership firm of Defenbaugh Finance Company of Clarksdale, Mississippi, was engaged in a loan brokerage business under the terms and provisions of the Small Loan Regulatory Act, being Chapter 170 of the General Session Laws of Mississippi of 1958. That the partnership firm was duly licensed and qualified under the terms and provisions, not only of the Small Loan Regulatory Act, but also under the terms and provisions of the Small Loan Privilege Tax Act, being Chapter 168 of the General Session Laws of Mississippi of 1958, and operated at all times in and according to the terms and provisions of said statutes.

(4)

That the plaintiffs, who are husband and wife, filed a joint income tax return for the calendar year 1958, and also for the calendar year 1959. In these returns, the plaintiffs reported Joseph W. Torti's portion of the net

profits of the partnership firm for that portion of the calendar year 1958, in which said partnership was in existence, and for the calendar year 1959. That under date of September 21, 1961, the Internal Revenue Service made an additional assessment of income taxes against the plaintiffs for the calendar years 1958 and 1959, resulting in an assessment of additional income taxes for the calendar year 1958 in the sum of $889.82, and for the calendar year of 1959 of $1,534.42, which additional assessments resulted from the Internal Revenue Service adding additional income to the plaintiff, Joseph W. Torti, of $3,768.79 for the calendar year 1958, and $6,376.67 for the year 1959, which was alleged to be Joseph W. Torti's pro rata part of the additional net income alleged to have been made from the Defenbaugh Finance Company for said respective years. That the Internal Revenue Service arrived at these additional figures on the theory that certain brokerage fees of Defenbaugh Finance Company, because of loans made, in which that company acted as broker, and which fees were not actually received in the calendar year in which his proportionate part was charged to the plaintiff, Joseph W. Torti, in the additional assessment made against him, were constructively received by him, and were treated by the Internal Revenue Service as constructive receipts for the respective years in which the charges were made.

(5)

That payment was made by the plaintiff, Joseph W. Torti, to the District Director of Internal Revenue for the District of Mississippi, at Jackson, Mississippi, hereinafter referred to as the District Director, on October 14, 1961, for the additional assessment of income tax, in the aggregate sum of $2,701.86, and a photostatic copy of the

check by which the payment was made, is attached hereto as Exhibit "A" and by this reference, made a part hereof as fully as if written herein in words and figures.

(6)

That a claim for refund in the sum of $848.22 for the calendar year 1958, and $1,486.58 for the calendar year 1959, or the aggregate sum of $2,334.80, was made to the District Director on the 16th day of October, 1961, and a true and exact copy of said claim, together with the attachments thereto, is hereto attached as Exhibit "B" and by this reference, made a part hereof as fully as if written herein in words and figures.

That under date of May 7, 1962, the plaintiffs received a notice from the District Director to the effect that claim for refund had been disallowed, a copy of which notice is hereto attached as Exhibit "C" and by this reference, made a part hereof as fully as if written herein in words and figures.

That this is a civil action arising under the laws of the United States, being a suit for the recovery of money and the interest thereon, which money the District Director, by virtue and under color of his office as such, received and collected from the plaintiff, as Federal Income Taxes for the calendar years 1958 and 1959, and there is now no proceedings pending for the collection of any such money, other than this action. That this court has jurisdiction of this cause under the terms and provisions of Sections 1340, 1346 and 1402 of Title 28 of the United States Code Annotated, and other laws of the United States applicable thereto.

(7)

That said monies sought to be recovered by this action, were received and accepted by the Director of Internal

Revenue for the District of Mississippi, at Jackson, Mississippi, for said calendar years 1958 and 1959, at a time when they were not due and owing by the plaintiffs as income taxes, and without the plaintiffs being indebted to the defendant or the District Director, and the defendant ought not, in good conscience, retain and hold the monies so accepted and received by the District Director for the defendant, which is sought to be recovered by this suit.

(8)

That such assessment and collection, as hereinbefore set forth, is the basis of this action and arose out of the following facts, to-wit:

That the Defenbaugh Finance Company, hereinafter merely referred to, for brevity, as the Company, in which Rodney E. Defenbaugh is the actual owner, and the plaintiff, Joseph W. Torti, receives one-third of the net profits for his services in managing same, engaged in the loan brokerage business, as hereinbefore set forth, handled said business as hereinafter outlined. That prior to the date when the above-referred to Small Loan Regulatory Act and the Small Loan Privilege Tax Act became operative in the State of Mississippi, Rodney E. Defenbaugh was engaged in the small loan business, with offices at two localities in the State of Mississippi, and was operating under a contract with the North American Finance Company, a Mississippi corporation, with its principal offices at Jackson, Mississippi. Prior to the time when said laws went into effect, the operation was on a two-note arrangement, one note being made by the borrower to North American Finance Company for the amount of cash advanced by it to the borrower, plus the interest; and the other note for the brokerage fee being made to Defenbaugh Finance Company. However, after the new

law went into effect, only one note was taken, payable directly to the lender, and including the principal sum advanced to the borrower, the interest and the brokerage fee. That after said laws went into effect, the said Defenbaugh continued to operate under the terms and provisions of said statutes, and when the partnership arrangement was formed between him and the plaintiff, Joseph W. Torti, on September 1, 1958, they began, and have continued to operate the Defenbaugh Finance Company at Clarksdale, Mississippi, under the terms and provisions of said Acts of the Legislature of the State of Mississippi, which are here referred to. The Company acts as broker only, and when a borrower applies to it for a loan, it takes the note of the borrower for the amount of the loan, plus the interest, plus the service charges, commonly referred to, and hereinafter referred to as the brokerage fee, all in accordance with the schedule, as set forth in Section 9, Chapter 170 of the Mississippi Laws of 1958. That as fixed by said legal schedule, the interest plus the brokerage fee, when combined, amount to two per cent of the amount of cash received by the borrower, multiplied by the number of months for which the loan is extended, of this amount North American Finance Company, with whom the Company does business, receives interest on all cash advances at the agreed rate per annum, and the remainder of the amount of the note, over and above the interest and the sum received by the borrower thereon, is the brokerage fee, and for this brokerage fee the Company renders the necessary services incident to the negotiation of the loan, the investigation of the borrowers' financial standing and ability to pay, the value and ownership of the security offered for the loan, prepares the note and other necessary papers incidental to the loan, including any mortgage, deed of trust, collateral or pledge agreement, and forwards the

note to the North American Finance Company, receives the amount from it going to the borrower, delivers same to the borrower, prepares and secures the brokerage and agency agreement, and the necessary receipt incident to the loan, along with any required financial or credit statement. The Company is required, by North American Finance Company, to endorse the note with recourse, and to look after the collection of same, and each month, or on any other payment period, the Company collects the amount due and forwards the collection to North American. If default is made in the payment of any instalment when due, it is the duty and obligation of the Company to look after and undertake to make the collection, and if the Company is unable to collect the amount due within a reasonable time of the due date, it must, itself, pay to the lender, the full unpaid balance of the note, and if the Company is then unable to collect said amount, the loss taken thereon is the loss of the Company. The Company is required to pay any expenses incident to the negotiation and handling and collecting of the loan. That North American Finance Company, who is the lender on loans negotiated by the Company, is a licensed Mississippi lender.

(9)

That under its agreement with the lender, North American Finance Company, the Company can be legally required to maintain or deposit a reserve with said lender which may not exceed twenty-five per cent of the total outstanding balances of all loans handled through the Company. That it is very much to the advantage of the Company that this cash reserve be as low as possible, and it was found by the Company that if it did not require North American Finance Company to advance to the Company, the brokerage fees at the time the loan was

negotiated, and the amount to be received by the borrower was paid to him, that a lesser amount of reserve would be required of the Company, than could legally be required, if demand was made for the payment of the brokerage fees at the time the loan was negotiated. Therefore, the Company inaugurated the practice of not requiring payment of its brokerage fees at the time of the negotiation of the loan, but simply to collect its brokerage fees monthly, as and when payments were made by the borrower. That there were a number of reasons actuating the Company in handling the collection of its brokerage fees in this manner. (1) Its reserve with North American Finance Company was required to be only ten per cent of the total outstanding cash balances of all loans handled, instead of twenty-five per cent, as could be required; (2) the Company was required to service the loans, and it did not desire to collect in advance, brokerage fees which might never be collected by it, if the borrower defaulted in his payments, and the Company was required to make payment of the full amount to the lender under its unqualified endorsement of the note, and the brokerage fee would never be collected; (3) a substantial part of the service to be rendered by the Company, for which the brokerage fee was compensation, was the servicing and collecting of the instalments on the notes as they respectively matured, and it was best for the Company that it collect and receive its compensation for this service as the service was rendered, rather than in advance of the rendition thereof; (4) that the credit line of the Company with North American Finance Company would have been materially reduced if the Company had elected to require the lender to pay the brokerage fees to the Company in advance, and this credit line was of great importance to the Company and essential to its proper business operation;

(5) that if the Company had required the lender to pay its brokerage fee in advance, the lender would have discounted the brokerage fee at a six per cent rate, which would have amounted to 11.8% interest cost to Company, figured at simple interest, and instead of the Company receiving $19.00 on a lower 5% interest basis on a twelve months $1000.00 loan, which it ultimately received for its services, if it collected its brokerage in monthly instalments as it came due, the Company would only have received $16.92 on such a loan; (for a portion of the time covered, the interest charged by North American was at the rate of 5%, and for a portion of the time covered, was at 6% on the amount actually paid to the borrower by the lender.) (6) that the brokerage fee, at the time the loan was negotiated, had not been actually earned by the Company, and it had no right to such brokerage fee without substantial limitations and restrictions being placed thereon.

(10)

That the Internal Revenue Service, in making the additional assessment against the Company, under date of September 21, 1961, did so on the theory as hereinbefore set forth, that the brokerage fees on each loan were collectible at the time the loan was negotiated, and, therefore, was taxable against the respective partners in the Company, under the doctrine of constructive receipt of taxable income in the year in which the loan was negotiated. There is no statute providing for constructive receipt of taxable income, and the right to collect taxes on income constructively received is not based on any statutes or specific law or judicial procurement, but seems to be derived from Treasury Regulations which, in 1954, under Section 39.42-2 of the Federal Treasury Regulations, was defined, as follows:

"Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. If a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt."

(11)

The brokerage fee of the Company, on the respective notes and loans which it handled, was not credited and set apart to it, without any substantial limitation or restriction as to the time or manner of payment, or condition upon which payment would have been made, but there were material limitations and restrictions as hereinbefore set out, including, but not limited to the fact that much of the service necessary to earn the brokerage fee had not been performed, that the Company would have been penalized by the requirement to put up additional deposits and reserves, had the brokerage fee been taken at the time of the loan, and its credit line with North American Finance Company would have been greatly restricted, and it would not have received the

full amount of its brokerage fee, but would have received same, less an interest discount of 11.8% simple interest.

That the Internal Revenue Service, in making the additional assessment, seemed to go on the theory that the brokerage fee was payable by the lender, North American Finance Company, however, the brokerage fee was not payable by the lender, but under the brokerage agreement with the borrower, same was payable by the borrower. Attached hereto as Exhibit "D" and asked to be taken and considered as a part hereof as fully as if written herein in words and figures, is a true and exact copy of the form of brokerage agreement, signed by each borrower, which specifically contains an agreement on the part of the borrower to pay the brokerage fee. However, it is not contemplated in these agreements, that the brokerage fee will be paid by the borrower at the time he secures the loan, but that it be paid in monthly or periodic instalments by him, and there is no obligation on the part of the lender to pay or advance the brokerage fee at the time the loan is negotiated. For the Company to have collected this brokerage fee at the time the loan was negotiated, would have required a new and independent contract with the lender, by the terms of which the Company would have simply been borrowing, for itself, the brokerage fee from the lender, less the discount mentioned above, as a result of which the Company would have suffered and sustained the penalties hereinbefore outlined, and would have been required to have paid interest thereon, as a loan by the lender to it, as hereinbefore set forth.

That if the Company could have borrowed the amount of its brokerage fee, less the discount, from the lender, at the same time the loan was advanced to the borrower, there was an agreement by and between the Company and

North American Finance Company to the effect that the brokerage of the Company would not be advanced, but would be collected by the Company from the borrower as the payments respectively matured on the loan. Once this election was made, as it was made, it was applicable to all loans negotiated by the Company, and the Company could not have received any of the brokerage from the lender, but could only collect same as it did, from the borrower, on the various payment dates of the respective loan. That is, once this agreement was entered into, the amount of the brokerage was not available to the Company and could not be drawn by it from the lender.

That, therefore, the brokerage fees of the Company did not fall under the classification of constructive receipts as to taxable income, as defined and outlined in the Treasury Regulation, hereinbefore quoted, and the assessment of the plaintiffs with one-third of the net additional amount of brokerage fees of the Company, charged to the plaintiff, Joseph W. Torti, in said additional assessment, was erroneously and improperly charged to the plaintiffs, and they were entitled to the refund applied for, and were not indebted to the defendant therefor, and same is sought to be recovered by this suit.

WHEREFORE, the plaintiffs pray for a judgment against the defendant for the sum of Two Thousand, Three Hundred, Thirty-Four and 80/100 ($2,334.80) Dollars, plus interest, at the rate of Six Per Cent per annum from the date of payment thereof, and for the costs of this action, and for such other and further relief as may be found proper by the Court.

/s/ FRED B. SMITH
Fred B. Smith, Ripley, Mississippi,
Attorney for the Plaintiffs.

IN THE UNITED STATES DISTRICT COURT NORTHERN DISTRICT OF MISSISSIPPI DELTA DIVISION

JOSEPH W. TORTI and
KATHERINE A. TORTI ..... Plaintiffs

v.

UNITED STATES OF AMERICA ..... Defendant

Northern District of Mississippi

FILED
NOV 9 1962
William T. Robertson, Clerk
By Melita Q. Lentjes, Deputy

ANSWER

The defendant, United States of America, by its attorney, Hosea M. Ray, United States Attorney for the Northern District of Mississippi, for its answer to the complaint, herein alleges as follows:

1. Admits the allegations contained in paragraph 1.

2. That it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 2.

3. That it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 3.

4. That it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 4.

5. That it is without knowledge or information sufficient to form a belief, as to the truth of the allegations contained in paragraph 5.

6. That it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 6.

7. Denies the allegations contained in paragraph 7.

8. That it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 8.

9. That it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 9.

10. That it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 10.

11. That it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 11.

WHEREFORE, defendant prays that the Complaint be dismissed with prejudice, and that the defendant be allowed its costs and disbursements.

/s/ Homer M. Ray
United States Attorney

/s/ J. W. WATKINS, III
Assistant United States Attorney

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF MISSISSIPPI

DELTA DIVISION

CIVIL ACTION NO. D-C-38-62

JOSEPH W. TORTI AND
KATHERINE A. TORTI ..... Plaintiffs

VS.

UNITED STATES OF AMERICA ..... Defendant

Northern District of Mississippi
FILED
JAN 29 1963
William T. Robertson, Clerk
By Melita Q. Lentjis, Deputy

REQUEST FOR ADMISSIONS AND INTERROGATORIES.

Comes the plaintiffs, Joseph W. Torti and Katherine A. Torti, and request the defendant, the United States of America, within fifteen (15) days after the service hereof, to make the following admissions, pursuant to Rule 36 of the Federal Rules of Civil Procedure, for the purpose of this action only, and subject to all pertinent objections to admissibility which may be interposed at the trial:

1. That the plaintiffs, Joseph W. Torti and Katherine A. Torti, filed a joint income tax return for the calendar year 1958, and also for the calendar year 1959.

2. That in these returns the said plaintiff reported Joseph W. Torti's portion of the net profits of the partnership firm of Defenbaugh Finance Company of Clarksdale, Mississippi, for that portion of the calendar year 1958 in which the partnership was in existence, and for the calendar year 1959.

3. That under date of September 21, 1961, the Internal Revenue Service made an additional assessment of income taxes against the plaintiffs herein for the calendar years 1958 and 1959, resulting in an assessment of additional income taxes for the year 1958 in the sum of $889.82; and for the calendar year 1959 in the sum of $1,534.42, which additional assessments resulted from the Internal Revenue Service adding additional income to the plaintiff, Joseph W. Torti of $3,768.79 for the calendar year 1958, and $6,376.67 for the calendar year 1959, which was alleged to be Joseph W. Torti's pro rata part alleged to have been made from the Defenbaugh Finance Company for said respective years; and that the Internal Revenue Service arrived at these additional figures on the theory that certain brokerage fees of Defenbaugh Finance Company, because of loans made, in which that company acted as broker, and on which fees were not actually received in the calendar year in which his proportionate part thereof were charged to the plaintiff, Joseph W. Torti, in the additional assessment made against him, were constructively received by him, and were treated by the Internal Revenue Service as constructive receipts for the respective years in which the charges were made.

4. That payment was made by the plaintiff, Joseph W. Torti, to the District Director of Internal Revenue Service for the District of Mississippi, at Jackson, Mississippi, on October 14, 1961, for the additional assessment of income tax, in the aggregate sum of $2,701.86,

and that the photostatic copy of the check set forth as Exhibit "A" to the Bill of Complaint in this cause, is a true and correct copy of the check by which such payment was made.

5. That a claim for refund in the sum of $848.22 for the calendar year 1958, and $1,486.58 for the calendar year 1959, or the aggregate sum of $2,334.80, was made to the District Director on or about the 16th day of October, 1961, and that Exhibit "B" to the original Bill of Complaint herein, is the true and exact copy of such claim as made to the District Director.

6. That said District Director gave notice on or about May 7, 1962, to the plaintiffs disallowing said claims for refund, set forth as Exhibit "B" to the Bill of Complaint, and that Exhibit "C" to the Bill of Complaint are true and exact copies of the notice of disallowance of said claims given by said District Director.

7. That the United States District Court for the Northern District of Mississippi, Delta Division, has jurisdiction of this carse under the terms of Provisions in Section 1340, 1346 and 1402 of Title 28 of the United States Code, Annotated, and other laws of the United States applicable thereto.

8. That there is set forth in Treasury Regulations of 1954, under Section 39.42-2 of the Federal Treasury Regulations, the following regulation:

> "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or

restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. If a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt."

9. That said regulation was in full force and effect at the time the additional income tax assessments referred to above for the years 1958 and 1959, were made against the plaintiffs herein.

10. That said Treasury Regulation is still in full force and effect.

11. That the additional assessment of income taxes, against the plaintiffs herein, for the calendar year 1958, in the sum of $889.82, and for the calendar year 1959, in the sum of $1,534.42, are made under, pursuant to, and by virtue of said Treasury Regulation, hereinbefore set forth, in request for admissions Number 8.

12. If the defendant should deny that such additional assessment of taxes against the plaintiffs for the calendar years 1958 and 1959, as hereinbefore referred to, was made under said Treasury Regulation set forth in request for admissions Number 8, above, then state in full upon what law, or laws, or regulation, or regulations said additional assessment of income taxes were made for said years.

13. If the defendant should deny that said additional assessment of income taxes for said years 1958 and 1959

were made on the basis or theory as set forth in request for admissions Number 3 above, then state on what basis or theory said additional assessment of taxes for said years were made.

/s/ FRED B. SMITH
Fred B. Smith
Ripley, Mississippi
Attorney for Plaintiffs

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF MISSISSIPPI

DELTA DIVISION

CIVIL NO. D-C-38-62

JOSEPH W. TORTI and
KATHERINE A. TORTI ..... Plaintiffs

v.

UNITED STATES OF AMERICA ..... Defendant

FILED

This 15 day of Feb 1963

William T. Robertson, Clerk
By Gena S. Lamb
Deputy Clerk

DEFENDANT'S REPLY TO PLAINTIFFS' REQUEST FOR ADMISSIONS AND INTERROGATORIES

The defendant, United States of America, by its attorney, Hosea M. Ray, United States Attorney for the Northern District of Mississippi, submits the following responses to the Plaintiffs' Request for Admissions and Interrogatories.

1. Admits the truth of the matters stated in paragraph 1.

2. Denies the truth of the matters stated in paragraph 2.

3. Admits the truth of the matters stated in paragraph 3.

4. Admits the truth of the matters stated in paragraph 4, except to allege that payment was made on October 17, 1961.

5. Admits the truth of the matters stated in paragraph 5, except to allege that the claims for refund were filed on January 24, 1962, and denies each and every allegation stated in said claims for refund, not specifically admitted.

6. Admits the truth of the matters stated in paragraph 6.

7. Admits the truth of the matters stated in paragraph 7.

8. Objects to request numbered 8 upon the ground that it refers to matters of law, not matters of fact, that the Regulations in question speak for themselves and that this Court may take judicial notice thereof.

9. Objects to request numbered 9 upon the ground that it refers to matters of law, not matters of fact, that the Regulations in question speak for themselves and that this Court may take judicial notice thereof.

10. Objects to request numbered 10 upon the ground that it refers to matters of law, not matters of fact, that the Regulations in question speak for themselves and that this Court may take judicial notice thereof.

11. Denies the truth of the matters stated in paragraph 11, except to admit that the additional assessment of income taxes was made pursuant to the statutes of the United States and Treasury Regulations issued thereunder.

12. Objects to request numbered 12 upon the ground that it refers to matters of law, not matters of fact, that the Regulations in question speak for themselves and that this Court may take judicial notice thereof, and see response to paragraph 11 above.

13. See paragraph 3 above.

/s/ J. W. WATKINS, III
Attorney, Department of Justice

WASHINGTON)
DISTRICT OF COLUMBIA) ss.

Joseph W. Watkins, III, being duly sworn, deposes and says: that he is an attorney for the defendant, United States of America, herein and has possession of the official files in this matter; that the answers set out in the foregoing instrument, based upon such files are true and correct to the best of his information and belief.

/s/ J. W. WATKINS, III

SUBSCRIBED AND SWORN to before me the undersigned authority on this 12th day of February, 1963.

/s/ W. E. HOUSE
NOTARY PUBLIC

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Defendant's Reply to Plaintiffs' Request for Admissions and Interrogatories was mailed this 12th day of February, 1963, to Mr. Fred B. Smith, Ripley, Mississippi.

/s/ J. W. WATKINS,
J. W. Watkins, III
Attorney
Department of Justice

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF MISSISSIPPI

DELTA DIVISION

NO. D-C-38-62

JOSEPH V. TORTI and
KATHERINE A. TORTI ..... Plaintiffs

v.

UNITED STATES OF AMERICA ..... Defendant

Northern District of Mississippi
FILED
JUN 18 1964
William T. Robertson, Clerk
By Malita Q. Lentjis, Deputy

STIPULATION OF DISMISSAL

This case having been compromised and settled in full, it is hereby stipulated and agreed that this matter be and the same is hereby dismissed with prejudice and with the parties to bear their respective costs.

/s/ FRED B. SMITH
FRED B. SMITH
Attorney at Law
Ripley, Mississippi
Attorney for Plaintiffs

/s/ H. M. RAY
H. M. RAY
United States Attorney
Oxford, Mississippi
Counsel for Defendant

I hereby certify that the foregoing is a true copy of the original thereof now in my office.

Attest Oct. 12, 1964

William T. Robertson,
Clerk
By Malita Q. Lentjis, D.C.

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1964

No._____.

MRS. EDNA BRITT ..... Petitioner

VS.

UNITED STATES OF AMERICA ..... Respondent

AFFIDAVIT

STATE OF MISSISSIPPI
COUNTY OF TIPPAH

Personally appeared before me, the undersigned authority in and for the County and State aforesaid, Fred B. Smith, who, after by me being duly sworn, on oath stated as follows:

That he is an attorney engaged in the practice of law in the City of Ripley, Tippah County, Mississippi. That he is a member of the Bar of the State of Mississippi, and of the Supreme Court of the United States of America. That he acted as counsel for the plaintiffs, Joseph W. Torti and Katherine A. Torti, in a cause instituted against the United States of America in the United States District Court for the Northern District of Mississippi, Delta Division, being Civil Action No. D-C-38-62 on the docket of said Court. That following the filing of the Bill of Complaint, Request for Admissions and Interrogatories, and reply thereto, and following a series of prolonged conferences between counsel for the plaintiff and defendant therein, the defendant acceded to the position asserted by the plaintiff in said

cause, and paid the plaintiff in full all sums sued for, whereupon the Stipulation of Dismissal in said cause was entered.

And further, affiant sayeth nothing.

/s/ FRED B. SMITH
Fred B. Smith

SWORN to and subscribed before me, this the 21 day of October, 1964.

/s/ LYNETTE PENNINGTON
Notary Public

My Commission Expires: Oct. 19, 1965